Wiener Institut für Internationale Wirtschaftsvergleiche

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The Silk Road: Challenges for the European Union and Eurasia

WKÖ Forum „Silk Road Reloaded“

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Topics covered

- Two competing integrations: European Union and Eurasian Economic Union
- Let in China, get the Silk Road
- Regional trade and FDI patterns: rising China, falling Russia
- Changing pivot to China – everywhere
- Impact on Austria
- Conclusions and Silk Road challenges

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Integration and disintegration: the EU vs CIS/EAEU (I)

- European Union (EU) remains attractive and is expanding, notwithstanding numerous problems and crises
  - After 60 years of evolution, the EU currently has 28 member states (Croatia joined in July 2013), with 510 million inhabitants and aggregate GDP of €14.000 billion
  - Eurozone currently has 19 member states (Lithuania joined in January 2015)
- A number of SEE/FSU countries are candidates or aspire for EU membership (e.g. Serbia, Turkey, Georgia, Moldova, Ukraine…)
- Yet some current EU members may leave (e.g. UK, Greece) or split (Spain/Catalonia)

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Integration and disintegration: the EU vs CIS/EAEU (II)

- Commonwealth of Independent States (CIS) was established after the dissolution of the Soviet Union in 1991
- CIS has currently 10 member states (Georgia left in August 2008, Ukraine in 2014), with 240 million inhabitants and aggregate GDP of close to € 2.000 billion
- A number of alternative integration endeavers on the post-Soviet space, mostly Russian-led and largely dysfunctional, exist (BY-RU-KZ Customs Union, SES, EurAz, GUAM, etc.)
- Customs Union and, since January 2015, the Eurasian Economic Union (EAEU) comprising RU, KZ, BY, AR and KG are the most important
- EAEU is modelled on the EU example („four freedoms", economic policy coordination, etc) in the perspective.

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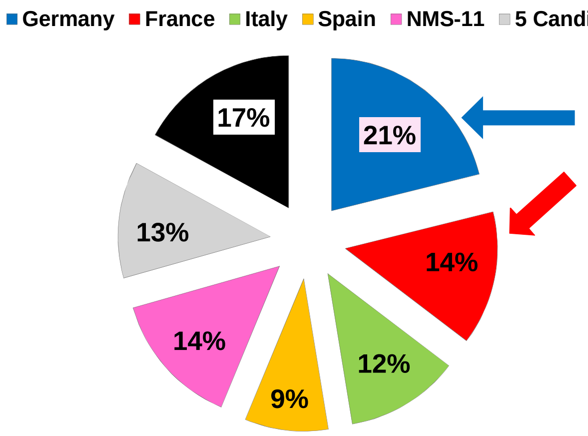
Economic dimension: Real GDP in the enlarged EU, in % of total (at PPP, year 2015)



Germany and France account together for 35% of enlarged EU economy

11 New Member States and 5 Candidates account for 30% of enlarged EU GDP

Sources: wiiw Database incorporating national and Eurostat statistics; own estimates.

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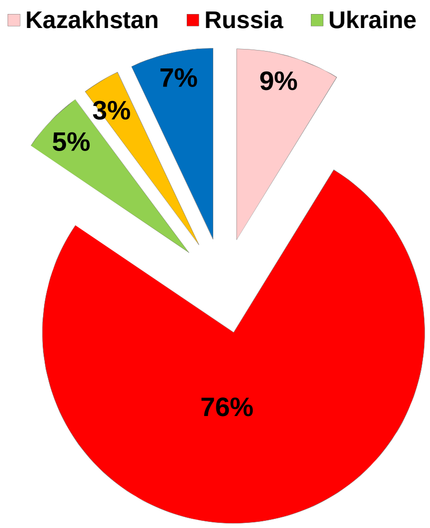
Economic dimension: GDP in the CIS/EAEU, in % of total



Russia dominates by far the CIS/EAEU economy

Ukraine would bring just a bit more balance

Rest of CIS/EAEU have little economic weight

Sources: wiiw Database incorporating national and CISSTAT statistics; own estimates.

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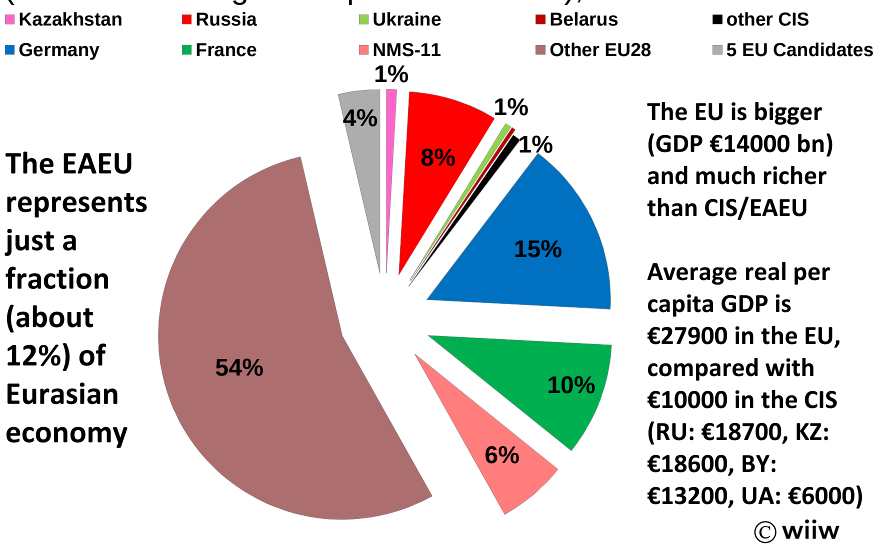
GDP in Eurasia (Lisbon-Vladivostok), in % of total, at ER (Eurasia = enlarged EU plus CIS/EAEU); estimate 2014



The EAEU represents just a fraction (about 12%) of Eurasian economy

The EU is bigger (GDP €14000 bn) and much richer than CIS/EAEU

Average real per capita GDP is €27900 in the EU, compared with €10000 in the CIS (RU: €18700, KZ: €18600, BY: €13200, UA: €6000)

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Sources: wiiw Database incorporating national, CISSTAT and Eurostat statistics; own estimates.

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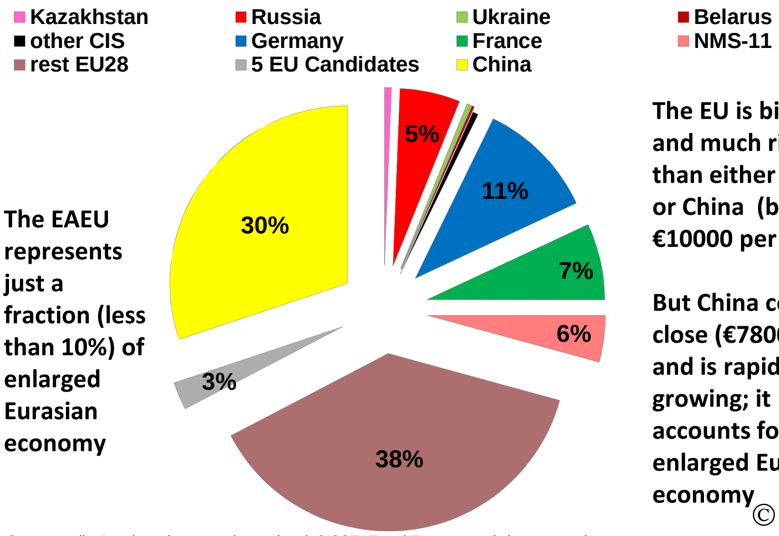
GDP in wider Eurasia (Lisbon-Vladivostok-Shanghai) (wider Eurasia = enlarged EU + CIS/EAEU + China; est 2014)



The EAEU represents just a fraction (less than 10%) of enlarged Eurasian economy

The EU is bigger and much richer than either EAEU or China (both cca €10000 per capita)

But China comes close (€7800 bn) and is rapidly growing; it accounts for 1/3 of enlarged Eurasian economy

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Sources: wiiw Database incorporating national, CISSTAT and Eurostat statistics; own estimates.

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Effects of Eurasian integration

- There seems to be little (economic) justification for Russia prompting Ukraine to join the Customs Union;
- Economic dominances have serious implications for integration success and sustainability (viz Germany-EU and Russia-EEU);
- Estimates of Customs Union, EU accession, EU Single Market, DCFTA, EU-USA Free Trade Agreements, effects differ widely;
- Long-run effects estimates are always bigger than short-run !
- Effects of non-tariff barriers are always more important than plain customs duties reductions !
- Estimation methods, data sources and model assumptions matter a lot in evaluations/interpretations of integration effects!
- See selected references attached for additional reading.

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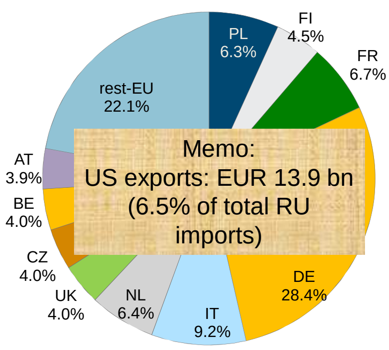
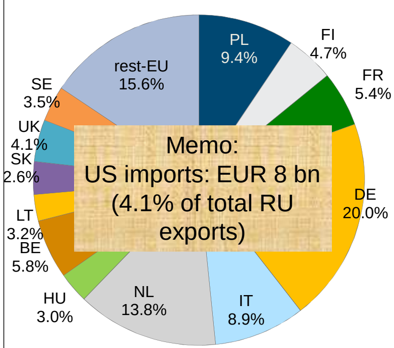
Russia's main trading partners in the EU, 2014
in % of total EU trade with Russia

EU exports: EUR 103.3 billion
(2.2% of total EU exports)



EU imports: EUR 181.8 billion
(4.0% of total EU imports)



Source: wiiw Annual Database, ROSSTAT

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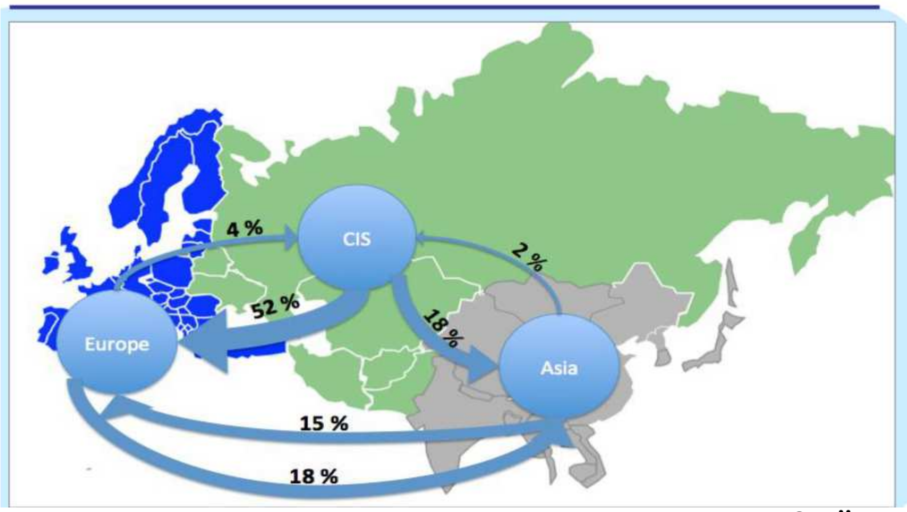
Trade flows EU - Eurasia (export shares, 2013)



Source: adapted from UN ECE (2015)

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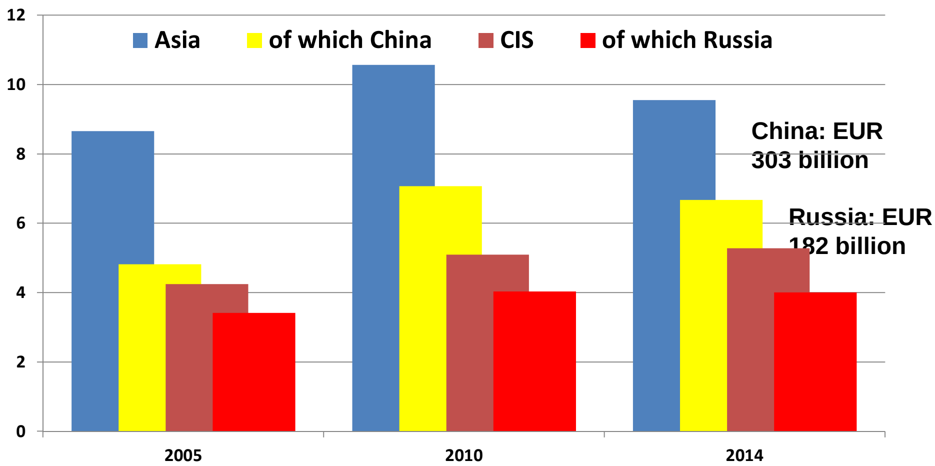
EU28 imports: shares of eastern regions in total



Note: Asia: China, Japan, India, South Korea; CIS: 12 FSU republics
Source: Eurostat Comext database; wiiw calculations

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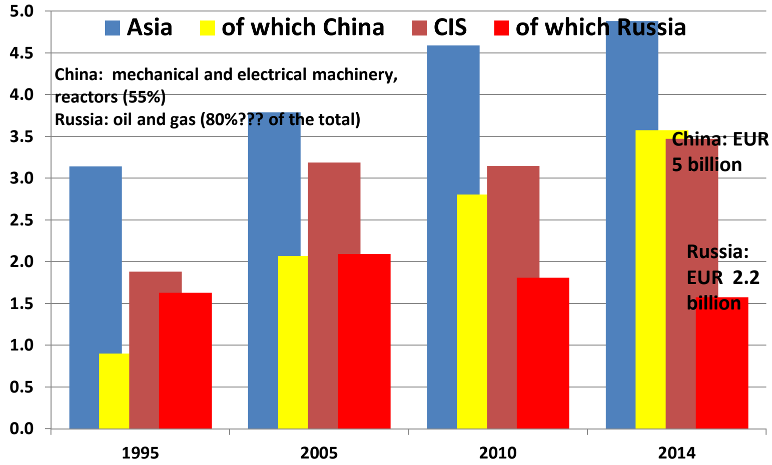
Austrian imports: shares of eastern regions in total



Note: Asia: China, Japan, India, South Korea; CIS: 12 FSU republics. 70% of Austrian imports from Russia not specified due to confidentiality (oil&gas).
Source: Eurostat Comext database; wiiw calculations

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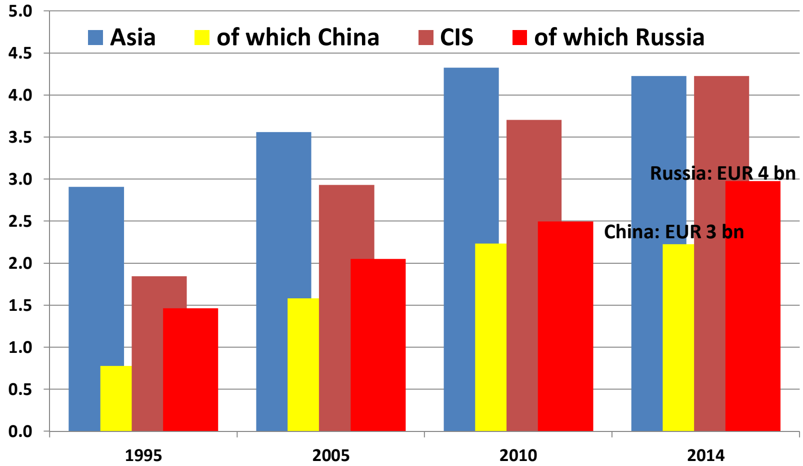
Austrian exports: shares of eastern regions in total



Note: Asia: China, Japan, India, South Korea; CIS: 12 FSU republics
Source: Eurostat Comext database; wiiw calculations

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Russia ‘stuck in transition’ already before Ukraine crisis escalated

- Energy exports revenues and growth sustainability
  - Increased pressures on energy supply diversification (both in the EU and RU)
  - Sectoral sanctions bite, no longer largely symbolic
  - Investment climate suffers, imports and FDI down, capital flight up
- Diversification and modernisation of the economy under threat
  - Growing reform pressures owing to lower oil price and sanctions?
  - Yet modernisation definitely more difficult without more FDI!
- Stability of the ruling elite threatened ?
  - Putin’s ratings grow, Russia’s ratings fall, rouble and MICEX fluctuate
  - Yet this may change with more hardship …
- Integration on the post-Soviet space derailed/fails?
  - Crimea and Donbas not really helpful for Putin’s Eurasian integration project
  - New design/reset of EU neighbourhood policies?
  - Pivot to China ?

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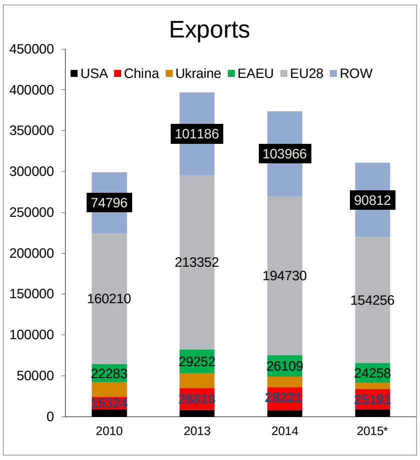
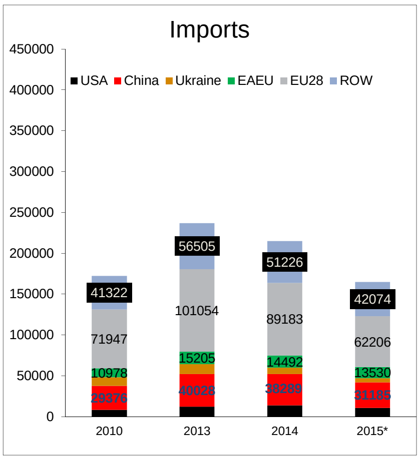
Russian foreign trade by partner regions (EUR mn): overall surplus (cca EUR 150 billion in 2015) yet a deficit with China (EUR 6 billion) and a sharp drop in trade with the EU (imports: -30% in 2015)





Source: wiiw Database incorporating national and Eurostat statistics.

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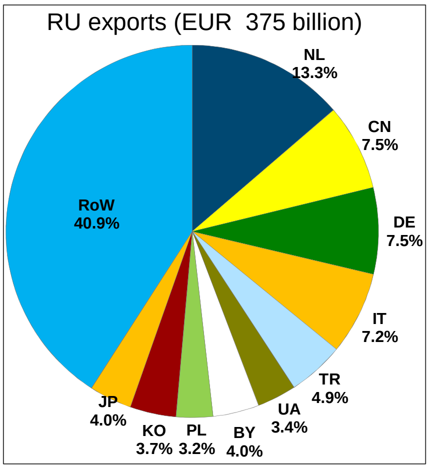
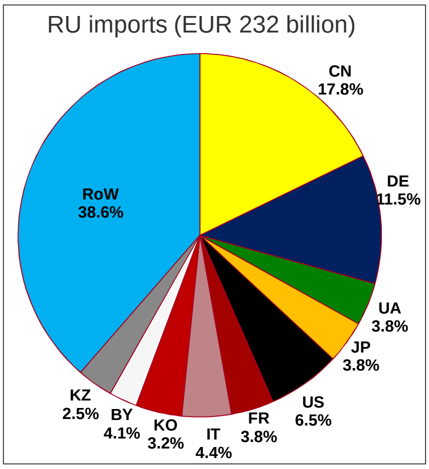
Russia’s main trading partners, 2014, in % of total





Source: wiiw Annual Database, national statistics.

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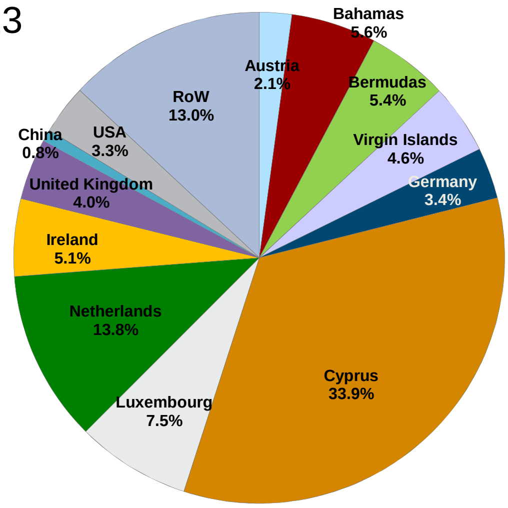
Russian inward FDI stocks: USD 566.5 billion, end-2013



Sources: wiiw FDI Database incorporating national statistics (CBR); own estimates.

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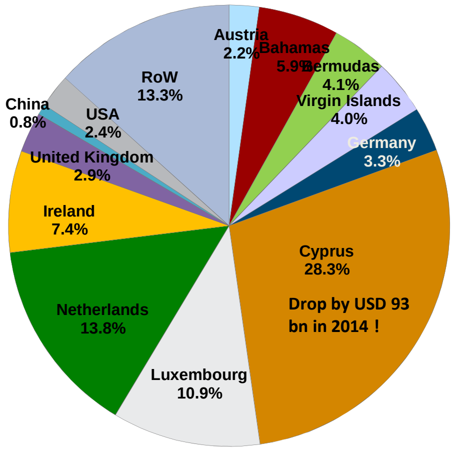
Russian inward FDI stocks fell by USD 212 bn within one year (to USD 353.4 billion, end-2014)



Sources: wiiw FDI Database incorporating national statistics (CBR); own estimates.

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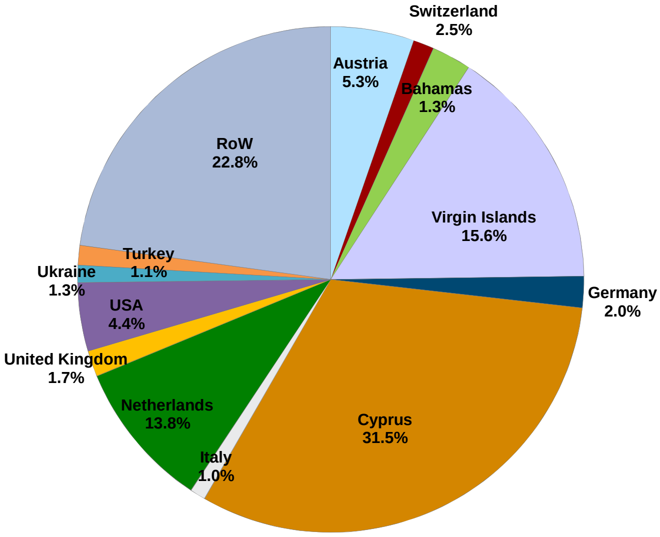
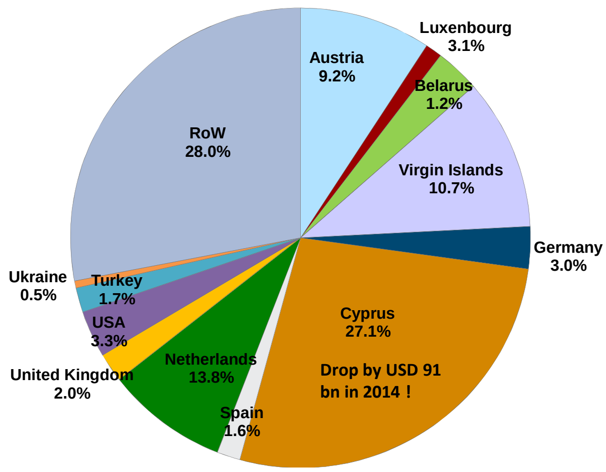
Russian outward FDI stocks: USD 479.5 billion, end-2013



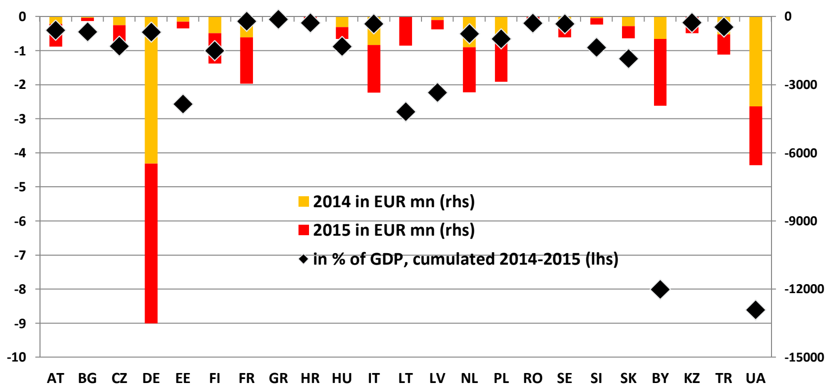
Sources: wiiw Database incorporating national statistics (CBR); own estimates.

Russian outward FDI stocks fell by USD 91 bn within one year (to USD 388.4 billion, end-2014)



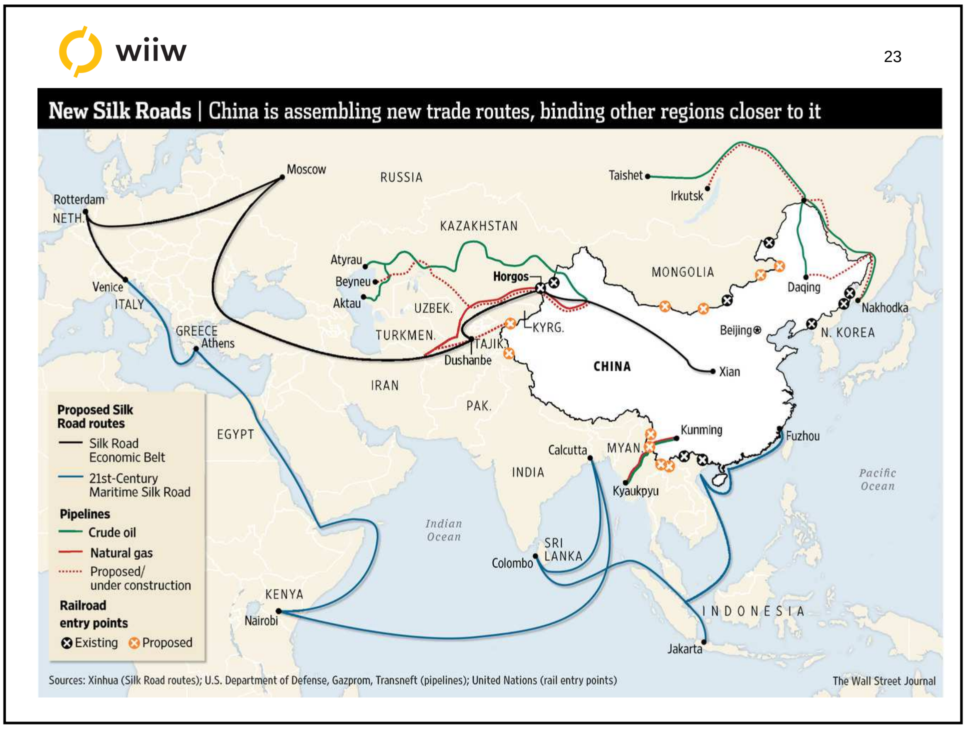
Sources: wiiw Database incorporating national statistics (CBR); own estimates.

Estimated losses due to reduced exports to Russia, 2014-2015



Note: Year 2015 estimated on the basis of the Russian Customs Statistics for the IH2015.

Sources: Eurostat, national statistics; wiiw estimates.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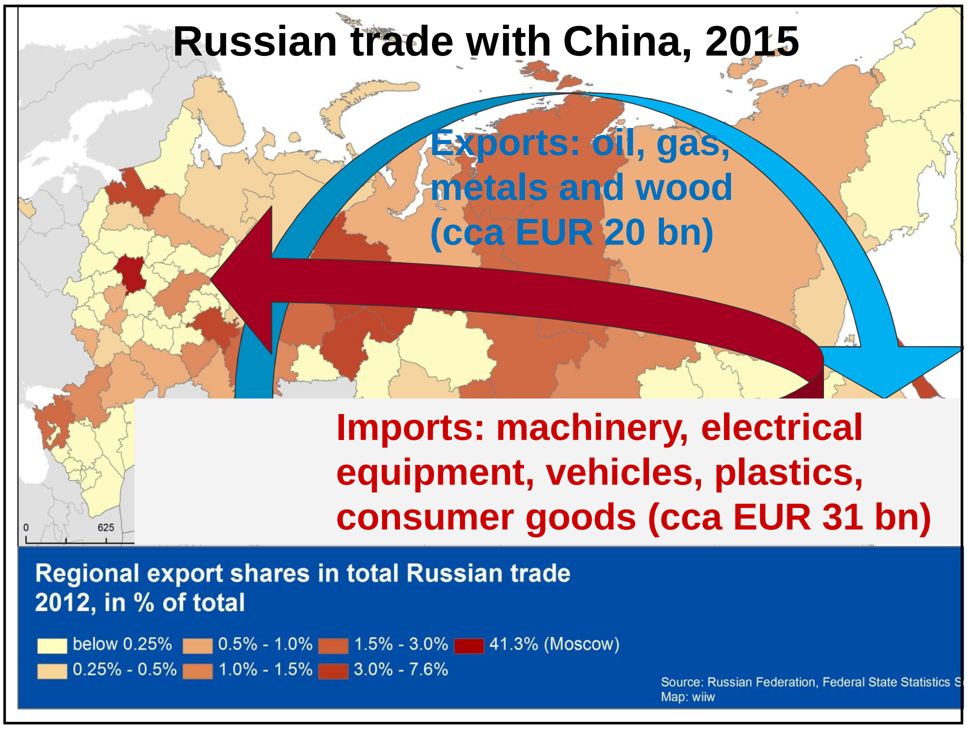
New Silk Roads | China is assembling new trade routes, binding other regions closer to it
Moscow
RUSSIA
Taishet
Irkutsk
Rotterdam
NETH.
KAZAKHSTAN
Atyrau
Beyneu
Aktau
Horgos
MONGOLIA
Daqing
Nakhodka
Venice
ITALY
UZBEK.
GREECE
Athens
TURKMEN.
KYRG.
TAJIK.
Dushanbe
Beijing
N. KOREA
CHINA
Xian
IRAN
PAK.
Proposed Silk Road routes
Silk Road Economic Belt
21st-Century Maritime Silk Road
Pipelines
Crude oil
Natural gas
Proposed/ under construction
Railroad entry points
Existing
Proposed
EGYPT
Kunming
Fuzhou
Calcutta
MYAN.
INDIA
Kyaukpyu
Pacific Ocean
Indian Ocean
SRI LANKA
Colombo
KENYA
Nairobi
INDONESIA
Jakarta
Sources: Xinhua (Silk Road routes); U.S. Department of Defense, Gazprom, Transneft (pipelines); United Nations (rail entry points)
The Wall Street Journal


Russian trade with China, 2015
Exports: oil, gas, metals and wood (cca EUR 20 bn)
Imports: machinery, electrical equipment, vehicles, plastics, consumer goods (cca EUR 31 bn)
0
625
Regional export shares in total Russian trade 2012, in % of total
below 0.25%
0.25% - 0.5%
0.5% - 1.0%
1.0% - 1.5%
1.5% - 3.0%
3.0% - 7.6%
41.3% (Moscow)
Source: Russian Federation, Federal State Statistics S
Map: wiiw

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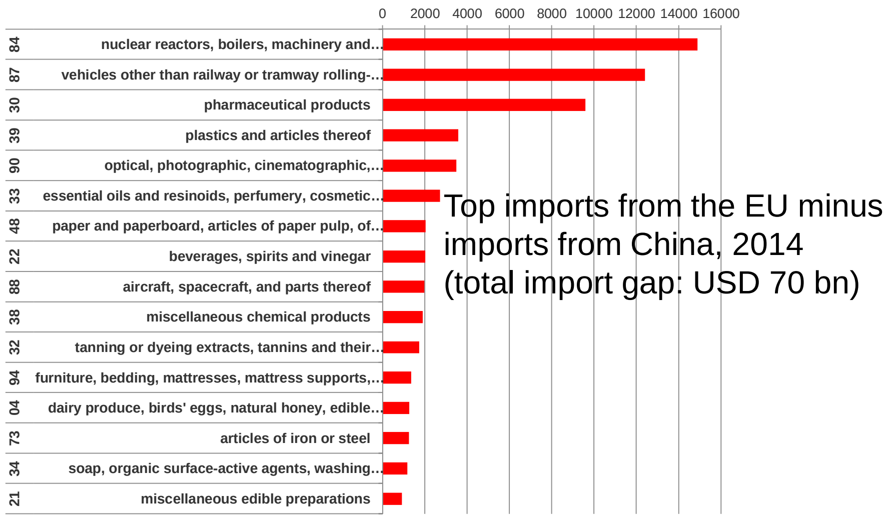
Russian Federation: Major EU-China import gaps, 2014



Source : wiiw calculations based on Russian customs statistics

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EU-China-Russia export specialisation asymmetry: implications for the Eurasian Silk Road (I)

- The EU (as well as Austria and Germany) exports specialise mainly on machinery, vehicles, aircraft and pharmaceuticals to both China and Russia (more than 50% of total EU exports);
- More than 50% of EU (and Austrian) imports from China are electrical and mechanical machinery;
- There is much evidence for a lot of EU-China intra-industry trade;
- In contrast, at least 75% of imports from Russia (both of the EU, Austria and China) are mineral fuels, additional 4% metals (iron, steel and aluminium), wood and fertilizers;
- Russian exports lack the diversity – energy prevails overall.

EU-China-Russia export specialisation asymmetry implications for the Eurasian Silk Road (II)

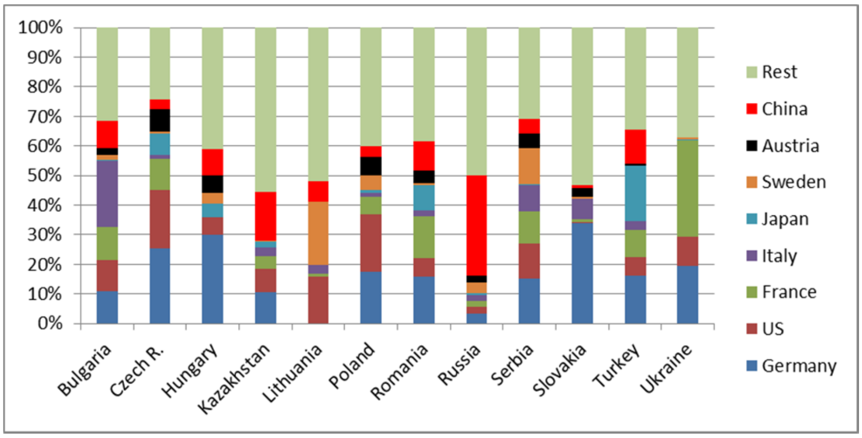
- Oil and gas pipelines from Russia to both East (China) and West (the EU) directions, the former yet to be constructed;
- Rail (containers) transit from and to China via Russia;
- Costs and other obstacles (e.g. Ukraine transit) hinder rail transport compared to air and sea;
- Chinese Silk Road Fund (USD 40 billion) and money from the Asian Infrastructure Investment Bank (up to USD 100 billion) ?
- Russian investment resources scarce owing to sanctions and low oil prices.

From China to Spain with the cargo train …

- 13000 kilometres from Yiwu to Madrid
- through Kazakhstan, Russia, Belarus, Poland, Germany and France
- 30 containers carrying 1,400 tonnes of cargo
- the journey was a test run to assess the viability of adding Spain to a route that already links China with Germany five times a week linking Chongqing, the huge industrial city in south-west China, with Duisburg, and Beijing with Hamburg
- it took three weeks to complete a journey that takes up to six weeks by sea;
- more environmentally friendly than road transport, which would produce 114 tonnes of CO2 to shift the same volume of goods, compared with the 44 tonnes produced by the train – a 62% reduction
- the cargo had to be transferred three times during the journey as a result of incompatible rail gauges. The locomotive had to be changed every 500 miles.

Source: adapted from UN ECE (2015)

Share of main investing countries in the capital investment pledged in greenfield projects, %, 2014

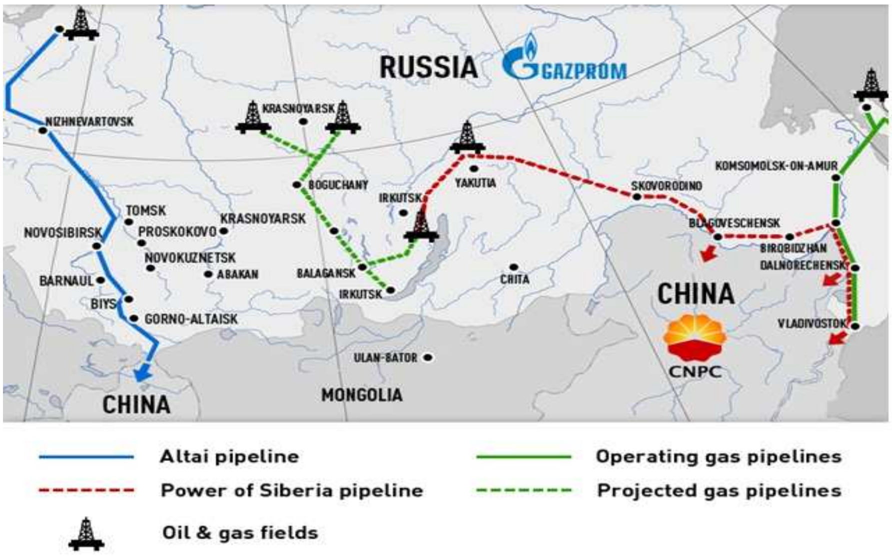


Source: Hunya (wiiw FDI Database, 2015)

Largest Chinese projects in Russian manufacturing announced in 2014

Investing Company	Parent Company	Administrative Region	Industry Sector	Capital Investment EUR million	Jobs Created
Hawtai Motor Group	Hawtai Motor Group	Not Specified	Automotive OEM	962.30	3000
Dongfeng Motor	Dongfeng Motor	Tatarstan Republic	Automotive OEM	437.41	2931
Dongfeng Motor	Dongfeng Motor	Saratov Oblast	Automotive OEM	87.48	586
Solar Systems	Harbin Electric	Tatarstan Republic	Electronic Components	106.71	1180
China Triumph International Engineering	China National Building Material Group (CNBM)	Ulyanovsk Oblast	Industrial Machinery, Equipment & Tools	2624.46	3000
Lifan International (Trading)	Chongqing Lifan Industry	Lipetsk Oblast	Automotive OEM	262.45	1500
BAIC International	Beijing Automotive Industry Holding	Not Specified	Automotive OEM	200.60	1415
Great Wall Motors (GWM)	Great Wall Motors (GWM)	Tula Oblast	Automotive OEM	454.91	2500
New Hope Group (NHG)	New Hope Group (NHG)	Tatarstan Republic	Food & Tobacco	437.41	1267

Source: Hunya (wiiw FDI Database, 2015)



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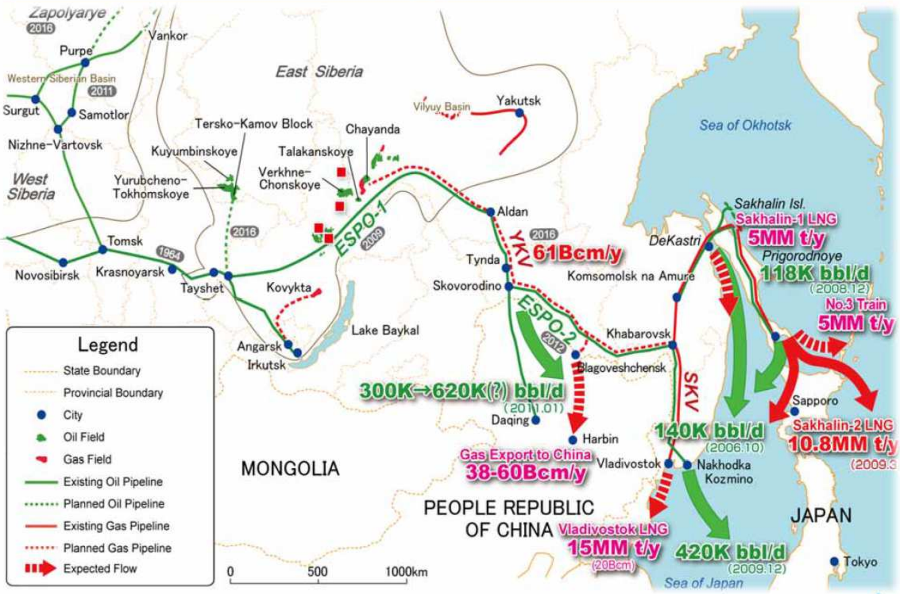
Source : Keun-Wook Paik, IIASA Energy Workshop, 12 May 2015

Drastic Increase of Energy Flow from Russia to Asia



Source : adapted from Paik (2015)

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Sino-Russian Gas Cooperation (Paik, 2015)

- The historic Sino-Russian gas deal from May 21, 2014 laid the ground for large scale pipeline gas supplies from east Siberia;
- The triggering point of this gas deal was the Ukraine crisis, but China became the biggest beneficiary of this special deal;
- If the eastern route deal (38 bcm/y for 30 years) is combined with the Altai route deal (30 bcm/y), it will wipe out almost 50 mt/y of LNG market from China's other suppliers;
- The Altai route will make Russia a Swing Supplier between European and Asian markets, yet its impact on the European market will be limited;
- The implications of Russian deals towards China's gas expansion, the regional and global trading in the coming decades will be substantial;
- Japan and Korean dreams to reduce the Asian LNG premium will be supported by fierce competition between imported pipeline gas and LNG in China;
- Reduced Asian premium will help the expansion of gas use in China and reduce the coal share below 50% in China's energy mix by 2030. This will be one of the most important contributions for the global climate change initiative;
- It is a real irony that Western sanctions against Russia indirectly help Sino-Russian gas deal's substantial contribution to China's energy revolution by reducing China's coal dependency.

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Why Altai Gas MOU? (Paik, 2015)

- On November 9, 2014, at the APEC Summit in Beijing, both President Putin and President Xi Jinping had witnessed the signing of MOU between Gazprom and CNPC. What drove China to accept President Putin's Altai initiative?
- A number of factors had affected China's blessing on the MOU. First, in June 2014, president Xi called for China's Energy revolution, which requires the reduction of China's dependence on massive coal use. Maximising the gas use is the most effective and practical solution. No harm to open another option for a large scale pipeline gas supply with the competitive price;
- Chinese leadership was always uncomfortable about its growing dependence on sea tankers oil and gas supplies;
- The pipeline supplies will reduce China's vulnerability to sea lane oil and gas supplies;
- To promote China's ambitious "Silk Road Economic Belt (SREB)" Initiative effectively, China needs an indirect support from Russia as the SREB Initiative is **completely bypassing Russia's territory**.
- China had to offer Russia something special to make sure no challenges or obstacles from Russia - the Altai project is ideal to serve the purpose.

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Sino-Russian Gas Cooperation (I)

- Implications of the Russian-China gas deals will be substantial;
- The Sino-Russian gas deal from May 21, 2014 laid the ground for a large scale pipeline gas supplies from East Siberia;
- For Russia, the triggering point of the May 2014 gas deal was the Ukraine crisis and related sanctions, but China became the biggest beneficiary of this special deal;
- If the eastern route deal (38 bcm/y for 30 years) is combined with the Altai route deal (30 bcm/y), it will wipe out almost 50 mt/y of LNG market from China.
- The Altai route will make Russia to a Swing Supplier between European and Asian markets, yet its impact towards the European market will be limited.

Source : Keun-Wook Paik, IIASA Energy Workshop, 12 May 2015

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Sino-Russian Gas Cooperation (II)

- If the Altai MOU becomes legally binding, it will have a big impact on the LNG supplies from USA to China;
- Japan and Korea's dreams to reduce the Asian LNG premium will be supported by fierce competition between imported Russian pipeline gas and LNG in China;
- Reduced Asian premium will help the expansion of gas use in China and to the decline of coal share below 50% in China's energy mix by 2030;
- Paradoxically, the Western sanctions against Russia indirectly help Sino-Russian gas deals and will contribute to China's reduction of coal dependence (and pollution).

Source : Keun-Wook Paik, IIASA Energy Workshop, 12 May 2015

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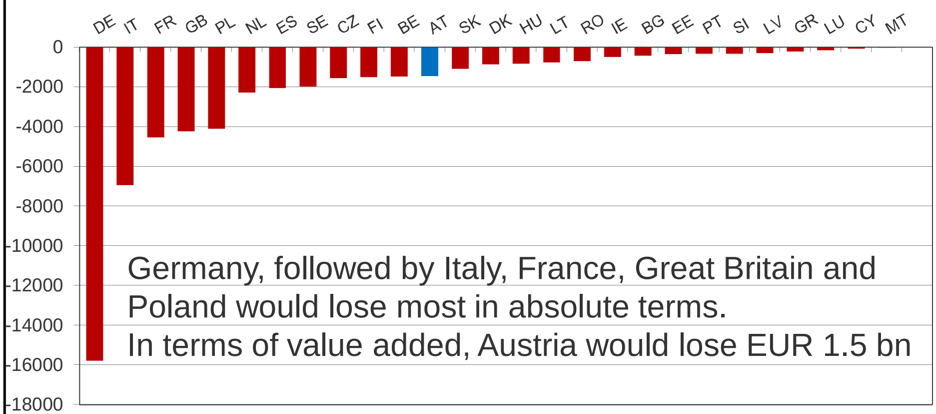
Scenario (II): Overall EU losses could add up to EUR 55 billion if goods and services exports to Russia drop by 50%



Source. Own estimates (Havlik, 2014).

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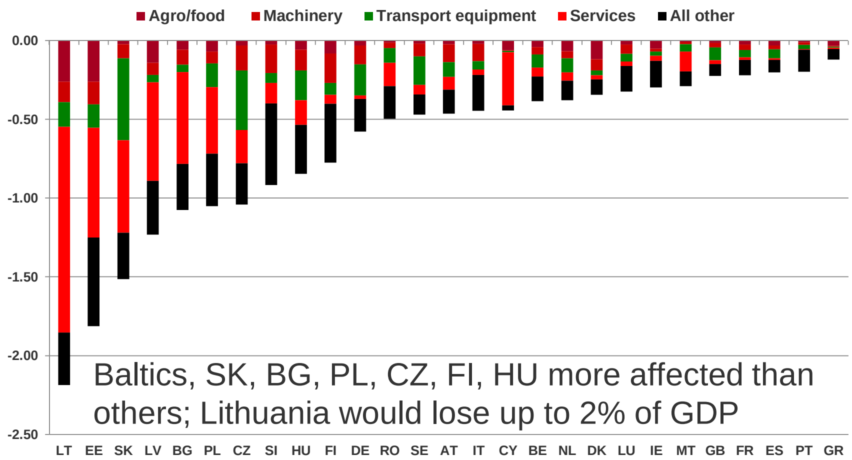
Scenario (II) sectoral impacts: estimated loss of GDP (in %) if gross exports to Russia drop by 50%



Source. Own estimates (Havlik, 2014).

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Impact of sanctions on the Russian economy

Decrease of funding from EU and US financial markets	Embargo on trade with dual-use technologies	Less FDI from the EU	Higher inflation	The reduction of production cooperation	Embargo on trade of oil drilling technology
EUR 115-150 bn	**EUR 4-5 bn**	**EUR 20-40 bn**	**EUR 15-20 bn**	**EUR 10 bn**	**up to 50-70 mn tons of oil lost by 2030 (up to EUR 25 bn at 70$ per bbl)**

In extreme case, the impact of sanctions could add up to 8-10% of Russian GDP according to estimates of Moscow's Institute of Economic Forecasting (Alexander Shirov, IIASA Workshop, 20 Nov. 2014).

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Conclusions and Silk Road Challenges

- The European Union and China dominate the wider Eurasian economy and marginalise Russia/EAEU;
- Russia has been 'stuck in transition' and needs the EU for modernisation imports, investment and export markets;
- Rising importance of EU-China trade; Russia on the decline;
- Trade asymmetries EU-Russia, EU-China and Russia-China;
- Silk Road, pipelines, rail, air and sea cargo challenges: capacity, costs and investment financing bottlenecks;
- Closer integration of the enlarged EU, Russia, EAEU, other Eastern Partnership countries and China could boost trade, investment and growth in a wider Eurasia;
- Yet geopolitics matter: a wider Eurasian integration – from Lisbon to Vladivostok and Shanghai – would relieve Ukraine and other Eastern Partnership countries from 'impossible' either/or choices.

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Selected references (I)

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Thank you for your attention!